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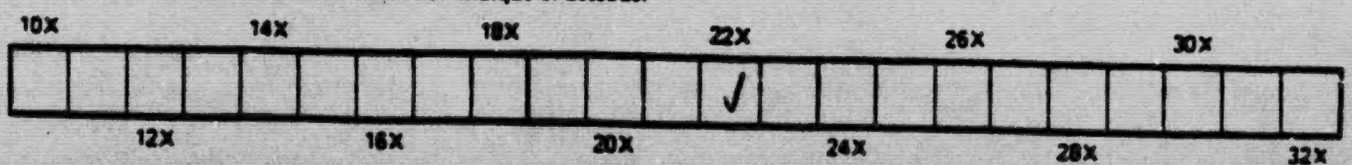

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The Banking System of Canada

— BY —

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Late Counsel for the Canadian Bankers' Association

1909

The Banking System of Canada

Lecture to the Third Year of the Law School, Toronto,
by Z. A. Lash, K.C.,
Chairman of the Legal Education Committee, February 1st, 1907.

THAT Canada is fortunate in her banking system and that in general it is well administered by able men seems to be admitted by all. That Canada is also fortunate in having that system subject to but one legislative authority, instead of having it dealt with by several, will be admitted by all who study the subject.

Before explaining what the present system is, a short reference to the past may prove instructive. You all know that the Dominion of Canada was constituted by the British North America Act, 1867. By Section 91 of that Act the exclusive legislative authority of the Parliament of Canada is declared to extend to

15. Banking—incorporation of banks and the issue of paper money.

16. Savings banks.

No institution so closely connected with commerce as a banking system, however perfect it may be supposed to be at the time of its creation and no matter how well it may answer its purposes in the beginning, can continue to serve properly the public interests in the ever-changing and developing stages of a growing country's trade, unless from time to time, as conditions change and new wants arise, the necessary changes are made in its constitution to enable it to meet properly the changed conditions.

An historical sketch of the banking systems of the various provinces which united to form the Dominion of Canada or which subsequently entered Confederation, and a comparison of these

systems with the system now in force would be interesting, but I must confine myself to a short reference to the conditions as they existed in 1867, when the Parliament of Canada first legislated on the subject, and to a short reference to the nature of that legislation and to subsequent legislation down to the Bank Act of 1890 and the Amendments of 1900, which now constitute the charters of all banks doing business in Canada.

You are of course all aware that the provinces which first entered Confederation were Nova Scotia, New Brunswick and the Province of Canada—formerly Upper Canada and Lower Canada, and now Ontario and Quebec—and that in each province there were banks doing business when the B.N.A. Act came into force. At the first session of the first Parliament of the Dominion of Canada, in the year 1867, an Act (Chapter 11) was passed, which declared that "Any Act or Charter incorporating any bank in the late Province of Canada or in the Province of Nova Scotia or New Brunswick shall, until the 1st of January, 1870, and thence until the end of the then next session of the Parliament of Canada, apply and have effect throughout the whole Dominion of Canada." This Act made some minor provisions respecting the powers of banks but did not assume to deal with their powers generally or to provide for them a charter. The main feature of the Act was to extend the scope of existing banks from the provinces to the whole Dominion and to fix a date when Parliament would have again to deal with the matter.

In 1870 by Chapter 11 of the Acts of that year a beginning was made to assimilate certain of the laws and charters relating to the various banks then in existence and to provide clauses which should form part of the charter of any newly incorporated bank. Some of the important provisions of the present Bank Act were then enacted and the Act of 1867 was extended "until the end of the session of Parliament commencing next after the first of January, 1872."

In 1871, by Chapter 5 of the Statutes of that year tolerably complete provisions respecting banks and banking were passed and made applicable to practically all the banks then doing business in Canada. Special provisions had necessarily to be made respecting certain banks doing business under Royal Charters and certain others to whose special constitutions all the general provisions were not applicable, but, speaking generally, this Act applied to all the banks so far as the public were

concerned, and though now repealed, it was the parent of the present Bank Act.

With certain limitations respecting capital stock and some other matters relating more to the shareholders than the public this Act repealed the charters of the various banks and declared that from and after a certain day "this Act shall form and be the charters of the said banks respectively until the first day of July, 1881."

Duration of Charters Limited to Ten Years

The important principle of limiting the duration of the charters for ten years was thus introduced. The wisdom of it is admitted by the banks themselves, in fact, in 1900 the Government offered to make their charters perpetual, but the Bankers' Association after full discussion deliberately resolved to ask the Government to have the charters continued for ten years only. Their reasons were the following:

They believed it to be in the public interest that the whole question of banking should be discussed generally by the banks and the Government at least once in every ten years, in order that a review of the past might be made with a view to improvements for the future, and in order that the system might be made as far as possible continuously suitable to the growing requirements of the country—and bankers are wise enough to know that whatever is truly for the public interests is in the last analysis for the true interests of the banks also. The fact that under our constitution the Government must practically take the responsibility of any legislation which may be required from Parliament upon so important a subject as banking, practically makes any important bill relating to it a Government measure, and, as any amendments to the Bank Act operate as amendments to the charters of the banks themselves, the Government, before proposing to Parliament any legislation affecting the charters, invites the banks to discuss the proposed measure before it is introduced. In this way a mutual understanding is reached and when both parties desire only what is fair and in the public interest the result cannot be other than beneficial. Therefore the banks desired this opportunity for mutual and general discussion to be preserved to them, and, in order that there might be stability and some reasonable period of rest after one revision of the system before another revision was discussed, the ten-year

period was adhered to, as it seemed to be the happy medium which gave the period of rest required and at the same time did not delay too long a reconsideration of the subject. Of course, there is nothing in the law to prevent Parliament from amending the Bank Act every session if it thought fit to do so, but in practice the matter works out in this way:—If after long and full discussions with the banks and the overhauling of the whole system and the consideration of amendments and suggestions from all quarters and the passing of an Act agreed upon by the Government and the banks, any one should during the next few years suggest further amendments the natural reply is: "The whole subject was fully considered only a few years ago and until we see how the changes then made work out it is too soon to make further changes." If a few years before the expiration of the ten years any one should propose amendments, the natural reply is: "It will only be a few years before the whole subject must be reconsidered and we prefer to wait till then rather than deal with it now." Of course if during the ten years some new development or pressing reason calls for further or new legislation the Banks themselves would either ask for it or assist in having it passed in the best form. There are several instances of this kind, but, speaking generally, the system is left at rest so far as legislation is concerned until the ten years are up. The Act is, as a rule, revised during the year preceding the coming into force of the revised Act; for instance it was revised in 1880, 1890, 1900, and the new Acts came into force on July 1, 1881, 1891 and 1901—the next revision will be in 1910.

In order that the Canadian system may be preserved intact in fact as well as in law, the Bank Act of 1890, by section 100, enacts "That every person assuming to use the title of Bank, Banking Company, Banking House, Banking Association or Banking Institution, without being authorized so to do by this Act or by some other Act in force in that behalf, is guilty of an offence against this Act."

The Canadian Bankers' Association

When the bankers met in Ottawa in 1890 to discuss the general revision of that year, they formed "The Canadian Bankers' Association" and adopted for it a constitution and by-laws. The principal object of the Association was to afford a medium through which the banks, as a whole, might speak

and to give to them an opportunity of meeting together in a formal and official way for the purposes of discussion and decision upon important matters. This voluntary Association proved so helpful in many ways that at the request of the Government it applied for incorporation in 1900, and by the Bank Act of that year it was made use of as part of the machinery for the winding up of insolvent banks, and was given very important powers respecting the making of bank notes intended for circulation, the delivery of these notes to the banks, the inspection of the disposition made by the banks of such notes and the destruction of notes of banks. Prior to this enactment each bank did as it thought best about the manufacture of its notes and about their use and destruction, and so long as it sent in the sworn monthly returns required by the Government no other bank had any right to any other information from it about its notes. Now, however, the Association follows the course of a bank note from its birth to its death. The reasons for this will be explained later on.

What a Banking System Should Do

Before referring more in detail to the Acts of 1890 and 1900, I will quote what one of our leading Canadian bankers, B. E. Walker (for many years General Manager and now President of the Canadian Bank of Commerce) has said about a banking system in order that it may answer the requirements of a rapidly growing country and yet be safe and profitable. In a paper read by him before the Congress of Bankers and Financiers, at Chicago, he said:

"1. It should create a currency free from doubt as to value, "readily convertible into specic and answering in volume to the "requirements of trade. In saying this I do not wish to be "understood as asserting that banks should necessarily enjoy "the right to issue notes. Whether they should or should not "issue notes must always, I presume, end in a discussion as to "expediency in the particular country or banking system.

"2. It should possess the machinery necessary to distribute "money over the whole area of the country so that the smallest "possible inequalities in the rate of interest will result.

"3. It should supply the legitimate wants of the borrower "not merely under ordinary circumstances, but in times of

"financial stress, at least without that curtailment which leads "to abnormal rates of interest and to failures.

"4. It should afford the greatest possible measure of safety "to the depositor."

Let us now examine how far our Canadian system answers these requirements.

Bank Notes or Currency

It should create a currency free from doubt as to value. Has it done so? The answer is unquestionably, yes.

In the first place, a new bank cannot obtain the right to issue notes until not less than $500,000 of capital stock has been *bonâ fide* subscribed and not less than $250,000 thereof have been paid in cash to the Minister of Finance and Receiver General, and until it has received a license from the Treasury Board (which is a Committee of the Government) to commence business. This license will not be given unless the Treasury Board is satisfied by proper evidence that all the requirements of the Statute have been complied with. When the license has been issued the $250,000 are returned and the bank may commence business and issue notes payable to bearer on demand and intended for circulation as money (Bank Act, 1890, Secs. 13 to 17); but the total amount of these notes in circulation at any time must not exceed the unimpaired paid up capital of the bank (Sec. 51). Heavy penalties are imposed for excess of circulation and any profits which the bank might derive from such excess are more than absorbed by the penalties, so that no inducement to over-issue exists; and the bank is prohibited (under heavy penalties upon its officers) from pledging or hypothecating its notes and no advance or loan made on the security of its notes can be recovered from it (Sec. 52).

The payment of the notes in circulation is by Section 53 of the Act made a first charge upon the assets of a bank in case of its insolvency and by Section 89, in the event of the property and assets of the bank being insufficient to pay its debts and liabilities each shareholder is liable for the deficiency to an amount equal to the par value of the shares held by him in addition to any amount not paid up on such shares. This is usually called the "double liability." In addition to all this, a fund called "The Bank Circulation Redemption Fund" is

created by Section 54 and every bank must keep to its credit in this fund, which is in charge of the Government, five per cent. upon the average amount of its notes in circulation from year to year. This average is ascertained from the monthly sworn returns during the year and the differences are adjusted as soon as possible after the 30th of June in each year. In the event of suspension by the bank of payment in specie or legal tender of any of its liabilities as they accrue, its outstanding notes bear interest at 5 per cent. from the day of suspension until public notice has been given of the day fixed by the liquidator for payment thereof, and they continue to bear interest if not then paid on presentation, and if arrangements are not made for payment of the notes within two months from the day of suspension the Government may pay the outstanding notes and interest out of the Bank Circulation Redemption Fund, and if the fund be thus depleted a call not exceeding one per cent. per annum to make up the deficiency, may be made upon the other banks in proportion to their average circulation for the year. You will thus see that in the last analysis each bank in Canada is liable to make good any deficiency required for the payment of the notes of each other bank, together with interest thereon from the day of suspension. You will also now see the reason for giving the Bankers' Association the powers relating to the manufacture, delivery, disposition and destruction of notes above mentioned, for the banks being liable in the way explained for each other's notes, are entitled to see that such liability is not enlarged by an over-issue or other improper or careless means.

It is impossible to conceive that the holder of a Canadian bank bill can ever lose any part of its amount, for he has the following securities for its payment:

(1st.) A first charge upon the entire assets.

(2nd.) The "double liability."

(3rd.) The Bank Circulation Redemption Fund.

(4th.) The obligation upon the other banks to maintain this fund so that each will at all times have to its credit therein 5 per cent. of the average of its outstanding circulation for the year.

You will better appreciate the extent of the security afforded by the first charge on the entire assets, when I tell you that on the 31st December, 1906, the total of the notes in circulation of all the banks in Canada was $78,416,780 and the total of their

assets, not including the double liability of shareholders, was $954,192,546, or more than twelve times the circulation. I do not of course mean that in the case of each bank its assets are more than twelve times the amount of its circulation, as the proportion of the assets of one bank to its circulation may be less than that of another, but these total figures will give you an idea of the general situation and of the great difference between circulation and assets.

You will also better appreciate the security afforded by the obligation of each bank to maintain its proper proportion of the redemption fund when I tell you that the total paid up capitals of all the banks was on December 31st, 1906, $95,509,015 and their total rests or reserves of surplus profits was $69,258,007. So that before all the banks could become unable to pay their calls for the redemption fund $260,276,037 would have to be lost, this amount being made up as follows:

Capitals	$ 95,509,015
Double liability	95,509,015
Reserves or rests	69,258,007
Total	$260,276,037

Prior to the establishment of the redemption fund and to the addition of interest upon bank notes as above explained, the notes of an insolvent bank fell immediately below par, and though they were afterwards paid in full yet a serious loss fell upon such of the first holders who could not afford to wait and who had to sell their notes to speculators at a heavy discount, and those who could afford to wait lost the interest, but since the change in the law the notes of a failed bank have passed at par as readily almost as before the failure, because no one doubts their ultimate payment and other banks and financial institutions readily take them because they bear interest at 5 per cent.

I think I have said sufficient to show that our system has created a currency free from doubt as to value.

Bank Notes Readily Convertible

Is it readily convertible into specie?

The promise in a note is to pay on demand, and as Canada is on a gold basis and as nothing but gold and Dominion notes form a legal tender in discharge of a debt (except silver and copper

in trifling sums) and as a bank dare not refuse payment in specie or Dominion notes, unless it intends to go into liquidation, it follows that the notes are convertible on demand into gold or into that for which gold can be at once obtained, if desired. Section 55, of the Act of 1890, provides that each bank shall make such arrangements as are necessary to ensure the circulation at par in any and every part of Canada of all notes issued by it, and that towards this purpose the bank shall establish agencies for the redemption and payment of its notes at Halifax, St. John, Charlottetown, Montreal, Toronto, Winnipeg and Victoria and at such other places as are from time to time designated by the Treasury Board. These arrangements have been made and the result is that no matter where a note may be payable on its face it must be redeemed, or in other words converted into specie, at a convenient place in the various Provinces of Canada, if presented for that purpose. Before these arrangements were made compulsory, some banks in the far west charged to the holder of a note payable in the far East a commission or collection charge upon it, and some banks in the far East returned the compliment to the far West, but now nothing of the kind takes place and so long as a bank continues to do business with open doors its notes are readily convertible into specie all over Canada. In what I have so far said on this head, I have assumed that the conversion would be by the issuing bank direct to the holder seeking the specie, but as a matter of fact and practice the holder need not go to the issuing bank itself, for any bank with which he does business will accept as cash on deposit or in payment of liabilities the notes of any other bank and will, unless the circumstances be special, even give gold for them, thus making them in fact readily convertible.

I will explain under the next head how a bank receiving the notes of another bank usually deals with them. What I have said shows, I think, that the Canadian banking system has created a currency readily convertible into specie.

Volume of Circulation is Elastic

Does it answer in volume to the requirements of trade?

So far it undoubtedly has done so, and so long as the paid up capitals of our banks are large enough in the total to enable the banks to issue in the total all the notes which the requirements

of trade demand, the requirements will be met in practically the exact proportions required. When the capitals become insufficient for this purpose they can by a simple and inexpensive process be enlarged, and to assist in supplying the want new banks can be created. The capitals of many of our banks have been increased during the last few years and several new banks have been established. If the great expansion in trade which is now going on continues much longer, we shall probably see a further substantial increase in the banking capital of Canada, but if the expansion still continues, we can hardly expect that the banking capital will go on increasing, and it is not improbable that some other means to meet the situation will be adopted based on sound principles, such as a central gold reserve put up by the banks themselves, against which, dollar for dollar, they may issue circulation in excess of their paid-up capital. This is not unlikely, as in an agricultural country like Canada, the marked increase in the demand for currency—what electricians would call the "peak of the load"—takes place in the fall when the grain crops and other products of the soil are being moved. This increased demand lasts only a few months and then the notes issued to meet it find their way back to the banks and remain idle till the next fall. Banks with a large capital, which have during nine months of the year ample circulation to meet the requirements, cannot be expected to increase that capital to any great extent, merely to enable them to issue notes against the increase which will remain out for 3 months only, while at the same time the dividends on the increase must be earned and paid for the whole year. In the case of banks paying large dividends this would soon become too burdensome to be continued. Therefore, I say, that if the expansion continues it is probable that some other sound means than an increase of capital will be devised to meet the requirements.

I have said that the requirements of trade are met by the circulation in practically the exact proportions required. The system works out in this way. A certain amount of the notes of each bank is of course constantly in circulation, but as the demand increases—for instance in the fall when the crops are being moved—more notes are paid out. After these notes have served their purpose and are no longer required for use from hand to hand, they always find their way into the banks, including of course the issuing bank, by deposits from customers or in

payment of obligations. Now, as a bank gains nothing by paying out notes other than its own, it very soon, generally the following day, presents to the other banks for payment all their notes which it has received and payment of them must be made in gold or Dominion notes. These presentations are made through the Clearing House if there be one in the place, and to facilitate the payment the Government supplies the banks with Dominion notes of large denominations. As the demands of trade decrease there are less notes paid out and of course there are less in circulation, so that the system works automatically and with the necessary elasticity to meet neither more nor less the requirements from time to time. This is a great feature in our system and it is because of this daily redemption of notes that our currency has never become inflated. It answers in volume from time to time the requirements and no more than the requirements. Before leaving this branch of the subject I should point out that a bank cannot issue a note for less than $5.00 or for any sum which is not a multiple of $5.00. The notes forming our currency under $5.00 are issued by the Government.

The Branch System

The next qualification of a proper banking system is that it should possess the machinery necessary to distribute money over the whole area of the country so that the smallest possible inequalities in the rate of interest will result.

Our system performs this duty with admirable success and it does it by means of branches and agencies in various parts of the Dominion. Section 64, of the Act, expressly authorizes the bank to "open branches, agencies and offices" and this power has been very extensively used. At the present time there are 36 banks in Canada, and these banks have nearly 1,700 branches in 581 different cities and towns in Canada. Our two largest banks have together 286 branches in Canada. For all practical purposes of convenience to the locality each branch is a separate bank, but instead of being a small bank with a limited capital it has behind it the strength and resources of the large institution of which it is a branch. The branch system works in this way. In one locality where there are few if any factories or active businesses carried on and where the farmers are prosperous, the savings of the people will exceed the demands for money and

the deposits in the bank will exceed the loans. In another locality where business is brisk and money is in demand the deposits will not equal the loans. The bank takes from one branch the excess deposits and uses this excess in the branch where there is a deficiency. This takes place with many branches, the excess in one making up the deficiency in another, with the result that the difference in the rate of interest charged to borrowers in different parts of Canada, except just now in the Northwest, is largely accounted for by the express charges in sending money from one place to the other and by the loss of interest during transit. Of course, the prevailing rate in a community where the borrowings greatly exceed the savings will be higher than in a community where the contrary is the case, and where a rapid development is going on, such as in our Northwest, the interest rates will be maintained at a higher level than elsewhere, but even there the facilities possessed by the banks in obtaining and distributing money by means of their branches and the competition between them will keep down any excessive rate.

The Borrower

A proper banking system "should supply the legitimate wants of the borrower not merely under ordinary circumstances but in times of financial stress, at least without that curtailment which leads to abnormal rates of interest and to failures."

The branch system is almost essential in order that this requirement may be properly met.

I have not so far made any comparison between the Canadian banking system and that of any other country—time would not permit of this,—but I can best illustrate the division of the subject which we have now reached by referring to the conditions in the United States. There the branch system is not in force, and the result is that the excess of the people's savings in one community does not readily find its way to the place where a deficiency exists. Banks in the East, as a rule, have immense deposits, and lend largely to banks in the South and West, by rediscounting customers' paper and by direct loans, but this is very different from a bank, say in New York or Boston, sending to its branches in the South or West, the excess on hand, to be loaned direct to customers of those branches. The capitals and resources of most of the banks doing business in the thousands of towns and small

cities of the United States are too small individually to supply the wants of the active businesses in their communities. One of three things therefore happens, and frequently all three happen, viz.: the bank must re-discount the customers' notes with another bank at a distance or the customer must himself go to another bank for some of his wants, or the borrower must sell his paper through a note broker, to whatever banks will buy it, the result is that a business requiring large advances, and not able to keep its active account with one large and strong bank becomes indebted to several banks, either because the notes have been re-discounted or because the loans have been made direct by different banks, or because the borrower's notes have been sold to various banks. Contrast this with the branch system where every branch, no matter how small the place, has behind it the resources of the parent bank, and where the parent bank has a special interest in the customer and a stake in the community where the customer is, and then consider the different results in time of stress and distrust. In the one case the chances are that the borrower has no bank sufficiently interested in him or sufficiently strong, if interested, to give further assistance. Each bank is too apt to look out for itself. The notes mature. The banks holding them have no special interest in the maker or in his community. Distrust prevails. Payment of the notes is demanded and further advances or rediscounts are declined, the lending banks for their own protection must call on the borrower to pay; this happens with all his loans; he may have ample means to pay in full if helped over the period of stress, but he cannot get help, and through no fault of his and through no fault of his bankers, but simply because of the banking system, he has to fail. In the other case conditions are different for in Canada it is the exception when a borrowing active business keeps more than one bank account. Our banks will not as a rule lend to a customer who borrows from another bank and our banks seldom, if ever, rediscount their customers' notes. The result is that in this country the borrower finds himself indebted to one bank only. He consults his bank. Head office is communicated with and the case is considered on its merits by those who, in the first place are able to help if help be decided upon, who in the second place have no other banks to consult, and who in the third place have a very special interest in the borrower and

in the community where his business is being carried on. If the case deserves help, help is given and the borrower, not because his case is more worthy of help than that of his brother across the line, but because the banking system is different, is saved from ruin.

That this is not a fanciful picture is shown by what happened in 1893 where stress and distrust in all kinds of businesses existed in the United States and Canada. In that year six hundred banks suspended payment in the United States, mainly through failures of their debtors, and only two hundred and two resumed business, whereas in Canada there was but one suspension, that of a small bank in Manitoba which had not been long in business. Its notes were promptly paid in full and its depositors and creditors received one hundred cents on the dollar.

The Depositor

My last text is, that a banking system should afford the greatest possible measure of safety to the depositor.

The relation of a bank to its depositor is that of debtor to creditor. The bank is in no sense a trustee for the depositor of the money deposited; the money in law is lent by the depositor to the bank and the bank is entitled to use it for its own benefit and to retain whatever profit may arise from such use—without liability to account therefor. There are some special incidents attached to this relationship of debtor and creditor which do not apply in the ordinary case. For instance, deposits are repayable by cheque on demand unless otherwise expressly agreed, and if a bank without valid reason refuses to cash a depositor's cheque when there are funds available, damages may be recovered for injury to the depositor's credit. The depositor has no security for repayment of his deposit other than that afforded by the ability of the bank to meet its engagements, including in this the double liability of its shareholders.

The Management

Safeguards and restrictions relating to the use which the bank may make of monies received from depositors may be established, a rigid system of Government returns published periodically may be enforced, Government inspection and fixed cash reserves may be required, the liability of the shareholders may be trebled instead of doubled, yet after all the real security

of the depositor depends upon efficient management of the bank. Efficient management includes and implies proper inspection and audit and if that be withheld it is probably because the management, although capable, is positively dishonest. No one can guard against absolute dishonesty. Therefore a system which tends to produce efficient managers skilled in the investment and loaning of money and having at hand a ready means of acquiring and keeping up accurate knowledge of local as well as of general business conditions, is more likely to afford a larger measure of safety to the depositor than a system which has not this advantage. Experience has shown that a system of banking with branches does produce efficient and skilled managers in greater numbers and with wider knowledge and experience than a system composed of separate and individual banks. It in fact creates and maintains a class of professional skilled bankers. Head office keeps in daily touch with the various branches, and frequent reports are required from the branches, not only of the affairs of their customers, but also of the business conditions in the locality. Clerks enter the service as juniors and are sent to various branches and moved from place to place before they become branch managers or responsible officers at head office or at branches, and even managers are transferred from place to place. In this way, in addition to learning the methods and business of his own bank, each member of the staff acquires a more thorough knowledge and grasp of general banking business and of the conditions existing all over the country than would be possible under other and more limited conditions. The Canadian banking system therefore possesses and will always produce efficient managers. I place efficient management first among the measures of protection to the depositor.

Powers of Investment

Sections 64 to 75 inclusive, of the Act of 1890, as amended in 1900, define the general business and investment powers of a bank. They are very wide and include "such business generally as appertains to the business of banking," but there are some clearly stated and important exceptions:

It must not, except as expressly authorized by the Act, "directly or indirectly deal in the buying or selling or bartering

"of goods, wares and merchandise or engage or be engaged in "any trade or business whatsoever, and it shall not either "directly or indirectly purchase or deal in or lend money or make "advances upon the security or pledge of any share of its own "capital stock or of the capital stock of any bank, and it shall not "either directly or indirectly lend money or make advances upon "the securi'y, mortgage or hypothecation of any land, tenements "or immoveable property or of any ships or other vessels or "upon the security of any goods, wares and merchandise."

The principle involved in these exceptions is accepted by the bankers as sound and not to be departed from. It is this, that as the bulk of a bank's liabilities is payable to depositors on demand or at short dates, the monies received from depositors shall not be tied up in loans upon, or purchases of, real estate or goods, or otherwise be so used that they cannot be readily converted so as to meet the demands of depositors. The prohibition against lending on the bank's own stock involves the same principle, and the prohibition against engaging in trade, in addition to involving this principle, involves the foundation principle of all sound banking, viz., that a bank's mission is to supply the borrowing business wants of those engaged in trade and to assist, but not to compete with them in developing the resources of the country.

The prohibition against lending upon the stocks of other banks is a wise provision, as but for it a bank unscrupulously managed and having a capital of say $1,500,000 might organize another bank with a capital of say $500,000, and might take and pay for the whole $500,000 of stock. The result would, of course, be that for all practical purposes the two banks would be one and the joint paid-up capitals would really be only $1,500,000, while they technically would be two banks with joint capitals equal to $2,000,000. Power to issue notes to the extent of $2,000,000 would, therefore, exist whereas this power should really be for $1,500,000 only. Other evils might also result if this prohibition were removed.

The cases expressly mentioned in the Act which form the exceptions to the prohibitions referred to are in harmony with the principles to which I have alluded. Power to hold real estate for the proper carrying on of the business of a bank is of course a necessary incident to its existence, and power to take security on real and personal property for existing liabilities properly

incurred in the course of its business is also necessary, and these powers are given. Power is also given to advance money for the building of a ship upon the security of the ship being built. This is in harmony with the encouragement of trade and commerce. The main exceptions are with reference to lending upon the security of goods, wares and merchandise. Sections 73, 74 and 75 contain these exceptions. They are necessary to the performance by the bank of its main duty, viz., to supply the borrowing business wants of those engaged in trade and to assist them in developing the resources of the country. Section 73 gives power to make advances on the security of a warehouse receipt for goods in possession of a warehouseman as baillee, or on the security of a bill of lading of goods in transit; and Section 74 authorizes the making of advances to anyone "engaged in business as a wholesale manu-"facturer of any goods, wares and merchandise upon the security "of the goods, wares and merchandise manufactured by him or "procured for such manufacture;" also to "any wholesale "purchaser or shipper of or dealer in products of agriculture, "the forest, quarry and mine or the sea, lakes and rivers, or to "any whosesale purchaser or shipper of or dealer in live stock or "dead stock and the products thereof, upon the security of such "products or of such live stock or dead stock and the products "thereof."

Experience has shown that under the powers of investment and of doing business possessed by our banks they are enabled to answer well the purposes for which they exist and at the same time to make money for their shareholders. Experience has also shown that the limitations upon their powers are wise and in the interests of the depositors whose money they acquire, and that in these respects our system affords a very decided measure of safety to the depositor.

Mutual Interests of Banks

A factor bearing largely upon this question and upon which great reliance may be placed is the mutual interests of the banks in the different parts of Canada and their common interest in averting a panic or a situation which would greatly disturb business and financial circles. This common interest brings them together, when help is required, and on more than one occasion a bank in difficulties has been able, with the

assistance of the other banks, to liquidate with open doors, thus avoiding the sacrifice of its assets and the inconvenience and loss to its customers which would inevitably result from the closing of its doors, and thus saving loss to its depositors and enabling it perhaps to make some return to its shareholders. In this way our system affords a real measure of security to depositors.

I will not occupy time by discussing the much debated questions of Government inspection and fixed cash reserves. Opinions as to the wisdom of these differ. They were fully debated with the Government in 1890 and the deliberate conclusion was come to, by the Government as well as by the banks, that Government inspection and fixed reserves were not suited to our conditions or to our banking system, and would be not only unnecessary and of no protection, but would be positively detrimental to the true interests of both depositor and borrower. The real protection to the depositor is what I have explained—(a.) Efficient management; (b.) prohibiting loans upon securities not of a liquid and convertible kind; (c.) the common interest which the banks have in averting panic or a situation which would greatly disturb business and financial circles; (d.) the double liability of shareholders.

To the above might be added as an incident to the branch system, that it is more likely that, out of a number of small individual banks, say fifty, having in the aggregate the same capital (say several millions) as a large bank with fifty branches, failures are more likely to occur which will cause loss to some depositors, than that the large bank, with several millions of paid up capital and with fifty branches, will fail with loss to its depositors. I will conclude by telling you that since 1890 when the banking system, which I have described, was established, in every case, so far as I can ascertain, of the failure of a bank forming part of that system where the liquidation has been completed, the depositors were paid in full except in one case, and in that one case they received ninety-nine and two-thirds cents on the dollar.

Z. A. LASH.

NOTE.—Since this paper was written the Revised Statutes of Canada 1907, have been brought into force and the "Bank Act" forms chapter 29 of those Statutes. In the revision the numbers of the Sections have been changed from those of the corresponding Sections above referred to.